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MEMORANDUM

CONFIDENTIAL

To: John B. Edmiston
From: Barbara A. Duncombe
Jeffrey Hannah
Date: March 18, 2003
Re: Anthem/FEP and Anthem Prescription Management

Please see our responses to the questions contained in your e-mail of February 26, 2003:

1. ***What is Rasp's business address?***

Thomas R. Rasp
Business Unit Account Executive and Assistant Treasurer
Anthem Prescription Management LLC
8990 Duke Boulevard
Mason, Ohio 45040-8943
Tel: 513.336.3351
Fax: 513.336.3311
Email: tom.rasp@anthem.com

2. ***How long has Rasp been the Anthem Prescription Management's Business Unit Account Executive?***

Tom has been the Business Unit Account Executive for FEP since late 1998. He has been at APM in various accounting and finance roles, including those related to FEP, since late 1995.

3. ***Do you know what year APM did not have supporting documentation re rebates?***

We have been unable to locate the APM True-Up Summaries for 1995, 1996 and 1997 although Bill Scott, the OPM Auditor who attended Mr. Rasp's interview, stated that OPM has these True-Up Summaries for every applicable year except 1997. We continue our efforts to locate them.

EXHIBIT

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4. *My notes are not clear on the procedural error that resulted in the incorrect amounts being tendered for rebates. I know that it had nothing to do with what the complainant was talking about, but I need to be able to explain what was up. Maybe I need to talk to you on the phone if that's OK.*

When Jeff, Tom and I were reviewing the True-Up Summaries in late January/early February 2003, we noticed that the APM FEP True-Up Summary had removed the expenses for the prescription mail service from the total APM administrative expenses total but had *not* removed the number of prescription mail service from the total script volume.

This is important because to true up both FEP's administrative expenses and its rebates, APM's allocation methodology was find the ratio of APM total scripts (less mail-in) to total FEP scripts (which APM believed did not contain mail in scripts). The percentage produced by this ratio was then applied to APM's administrative expenses *without* mail-in administrative expenses and to the total amount of rebates received for the entire year.

By removing the mail-in expenses from APM's total administrative expenses but leaving the number of mail-in scripts within its total script volume, it caused the total number of scripts to be higher, and hence, made FEP's share of that universe lower. APM, after identifying the error, has revised its Annual FEP True-Up Summary for years 1998, 1999, 2000 and 2001. We provided you with these revised calculations by letter dated February 13, 2003.

During the interview itself, we reviewed APM's true-up summaries with you and OPM auditor Bill Scott. The difference annually between the revision and the amounts included in FEP's year end true-ups is nominal but works in favor of OPM. Copies of these sheets were sent to you after the interview to enable you to review APM's previous and current calculations based upon this explanation.

Also, when Jeff, Tom and I reviewed the APM 2001 FEP True-Up Summary, we discovered a routine arithmetic error in the calculations shown. Specifically, the original 2001 Summary multiplied the Total Rebates Earned of \$77,126,606.00 by 98.96% (the share allocated to accounts other than FEP/HMP based upon sales volume) to show a reduction of \$76,486,455.17. From this, APM determined that OPM had received approximately \$40,000 more in rebates than it was entitled to receive. PLEASE NOTE: that when \$77,126,606 is multiplied by 98.96%, the amount to be subtracted *should have been* \$76,324,489. Thus, OPM's share of the 2001 rebates *should have been* \$802,123, which *should have resulted* in an additional payment to OPM of \$122,027.92. The adjustment of 02/03 corrects both the arithmetic error as well as the mail order re-adjustment.

The amount due OPM resulting from these errors is being returned to OPM through an adjustment to FEP's 2002 year-end cost report. However, please feel free to call if we can be of further help (or perhaps clearer) by telephone.

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5. **What is Anthem Midwest's (AMW) address?**

There is a legal entity named "Anthem Midwest, Inc." which is not an operating company, but is a holding company for a number of Anthem affiliates, including both Community Insurance Company (which holds the FEP/HMP contract with OPM) and Anthem Prescription Management, Inc.

Anthem Midwest, in the context of this matter, is not an entity, but is the name Anthem uses to describe its operations in Ohio, Kentucky and Indiana. In those states, Anthem operates from primary offices located in Mason and Cincinnati, Ohio; Louisville, Kentucky; and Indianapolis, Indiana. Anthem can be contacted through Jeff Hannah at 120 Monument Circle, M2SG, Indianapolis, Indiana 46204.

a. **Is AMW a part of APM, i.e., a division or subsidiary, or is it a totally separate, non-related business entity?**

See above.

b. **Did AMW operate at a profit regarding rebates to the government? If so, does that mean that AMW calculated rebates due the government minus its profit? And, if that is the case, would that not mean that the government did not get back the entire amount of the rebates paid to APM?**

Since approximately 1998, APM's arrangement with AMW is to pass back to AMW 80% of the rebate amount received; APM retains 20% of the rebate amounts for its expenses, profit, etc.

On a monthly basis, APM would determine the *estimated* amount of rebates which it expected to recover and booked 80% of that total monthly estimated amount to AMW. The reason why APM could only book an estimated amount to AMW (as well as all of its other accounts) is because the rebates offered were determined by different arrangements, different amounts and by the pharmaceutical companies depending, in some cases, on market share and because it took several weeks/months before APM actually received its rebates from those companies.

As Mr. Rasp explained, APM periodically *did* adjust the amounts of the rebates to its accounts, including AMW, to revise it to the agreed-upon percentage based on the actual rebate amounts received.

In turn, AMW performed its own internal allocation to determine what portion of the estimated rebate (which was only 80% of the rebate amount to be received by APM), AMW would return to its FEP/HMP customer. Thus, there should be a monthly rebate amount from APM to AMW and a monthly rebate amount from AMW to FEP. So, *during* each calendar year (since 1998), AMW was rebating to FEP its share of 80% of the estimated rebate amount which APM gave to AMW.

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Then, as the APM True-Up Summaries show, at year end, APM calculates what is FEP/HMP's *actual* share of its expenses (less unallowable account, unallowable cost centers, less any profit/fee) and FEP/HMP's *actual* 100% share of the realized amount of rebates.

From these total amounts (total expenses and total rebates), APM then takes the estimated amount already charged to FEP/HMP (for APM's expenses) and the estimated amount already credited to FEP/HMP as its share of the rebates received and subtracts them from the totals. The results are combined into a net adjustment to "true-up" the APM expenses and rebates which adjustment is made to the FEP/HMP administrative expenses.

Thus, regardless of what or how AMW passes through APM's administrative expenses and APM's rebates to FEP/HMP during the year, at the end of each year, APM and AMW do a true up to ensure that FEP/HMP receives only its allowable, allocable share of the actual expenses and its full, 100% share of the allocable rebates received. The interim basis is only for purposes of booking a recurring cost estimate rather than making one year-end charge. OPM appears to be familiar with this process and comfortable that it is designed for FEP/HMP to receive its correct charges and rebates on an annual basis.

6. *When we were discussing the fact that until about 3 years ago AMW was paying the government \$1 per rebate received and that it was trued-up at the end of the year, I did not really question Rasp about that mechanism. Was he in his current position at that time? If so, could he explain it to me and do you mind if I ask him? (Or, if you can explain it, that would be OK too.) I feel that the complainant probably was referring to when he said that the avg. rebate was \$4, but that APM made the conscious decision to only return \$1 per rebate to Uncle Sam.*

The \$1 or \$4 per script repayment structure was the mechanism by which APM passed back to its accounts what could be considered their fair share. It is roughly equivalent to the 80%/20% methodology which APM uses today. Mr. Rasp commented during his interview that the \$4 amount quoted seemed to be extremely high since, when APM used this sharing arrangement, the rebate amounts were not as high as they are today.

Under the flat dollar amount sharing arrangement, APM rebated to their accounts, including AMW, the flat amount (e.g. \$1) multiplied by the allocable number of scripts which APM handled for each particular account. APM paid the flat amount per allocable script volume, regardless of whether it received a rebate (of \$1 or \$2 or \$.10) or it received no rebate from the pharmaceutical company for that script. In turn, AMW used some mechanism to flow back to FEP its share of the rebate during the year, as discussed above.

However, at year end, APM and AMW performed the same type of true up that you see for the 80%/20% years. That is, APM removed the unallowable accounts, the unallowable cost centers, any profit/fee from its expenses allocable to FEP/HMP and then subtracted from the total expense amount allocable to FEP/HMP whatever had already been charged to FEP/HMP during

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the year by AMW. Similarly, APM determined the share of the total rebate amount allocable to FEP/HMP based upon its share of the overall total script volume.

As Bill Scott noted during Mr. Rasp's interview, since APM passed through to FEP/HMP (during the year) the designated per scribe rebate amount *on all scripts*, regardless of actual rebate, this methodology would work in FEP's favor to prevent any unfair treatment of FEP during the year or to cause any dramatic true-up at year's end.

That is the long answer. The short answer is that regardless of the sharing methodology used between APM and AMW during the year, APM always balances its account with FEP/HMP to cost at year end - both for expenses and for rebates.

7. *What is the meaning of life?*

"Happiness begins when selfishness ends." John Wooden, former basketball coach UCLA.

Conclusion.

If you have any questions regarding the above, please do not hesitate to contact me.

Barbara

BAD:db

**Anthem Prescription Management, Inc.
1998 FEP True-up
Summary**

Operating Expenses (Admin Fee)		Original	Adjusted 02/03
APM Operating Expenses		\$ 126,156,667.80	\$ 126,156,667.80
Less unallowed accounts		224,501.23	(224,501.23)
Less unallowed cost centers		(111,311,879.78)	(111,311,879.78)
Less allocations to Mail Services (non-FEP)		(3,320,234.81)	(3,320,234.81)
Base allowable to FEP		11,749,054.44	11,300,051.98
Allocation to other business based upon script volume	99.09%	(11,642,138.04)	(11,194,961.50)
FEP portion of operating expenses		106,916.40	105,090.48
Admin fee charged to FEP business		(83,530.54)	(83,530.54)
Adjustment to FEP business		\$ 23,385.86	\$ 21,559.94
Rebates Shared			
Retail Rebates Earned		Original \$ (33,164,829.35)	Adjusted 02/03 \$ (33,164,829.35)
Allocate to other business based upon script volume	99.09%	32,863,029.40	32,856,396.44
FEP portion of rebates earned		(301,799.95)	(308,432.91)
Rebates shared in 1998		163,435.00	163,435.00
Adjustment to FEP business		\$ (138,364.95)	\$ (144,997.91)
Net Adjustment To FEP			
Admin Fee Adjustment		Original \$ 23,385.86	Adjusted 02/03 \$ 21,559.94
Rebates Shared Adjustment		(138,364.95)	(144,997.91)
Adjustment Due To FEP Programs		\$ (114,979.09)	\$ (123,437.97)
			\$ 8,458.88

Anthem Prescription Management, Inc.
1999 FEP True-Up
Summary

Operating Expenses (Admin Fee)		
	Original	Adjusted 02/03
APM Operating Expenses	\$ 140,253,016.97	\$ 140,253,016.97
Less unallowed accounts	\$ (186,276.12)	\$ (186,276.12)
Less unallowed cost centers	\$ (122,180,525.04)	\$ (122,180,525.04)
Less allocations to Mail Services (non-FEP)	\$ (736,385.88)	\$ (736,385.88)
Base allowable to FEP	\$ 17,149,829.93	\$ 17,149,829.93
Allocation to other business based upon script volume	99.07% (16,990,336.51)	99.02% (16,981,761.60)
FEP portion of operating expenses	\$ 159,493.42	\$ 168,068.33
Admin fee charged to FEP business	\$ 109,195.92	\$ 109,195.92
Adjustment to FEP business	\$ 50,297.50	\$ 58,872.41

Rebates Shared		
	Original	Adjusted 02/03
Retail Rebates Earned	\$ (44,047,224.00)	\$ (44,047,224.00)
Allocate to other business based upon script volume	99.07% \$ 43,637,584.82	99.02% \$ 43,615,561.20
FEP portion of rebates earned	\$ (409,639.18)	\$ (431,662.80)
Rebates shared in 1999	\$ 375,234.86	\$ 375,234.86
Adjustment to FEP Programs	\$ (34,404.32)	\$ (56,427.94)

Net Adjustment to FEP		
	Original	Adjusted 02/03
Admin Fee Adjustment	\$ 50,297.50	\$ 58,872.41
Rebates Shared Adjustment	\$ (34,404.32)	\$ (56,427.94)
Adjustment Due to FEP Programs	\$ 15,893.18	\$ 2,444.47

**Anthem Prescription Management, Inc.
2000 FEP True-up
Summary**

Operating Expenses (Admin Fee)		
	Original	Adjusted 02/03
APM Operating Expenses	\$ 173,692,980.53	\$ 173,692,980.53
Less unallowed accounts	\$ (78,570.86)	\$ (78,570.86)
Less unallowed cost centers	\$ (158,477,007.27)	\$ (158,477,007.27)
Less allocations to Mail Services (non-FEP)	\$ (474,629.79)	\$ (474,629.79)
Base allowable to FEP	\$ 14,662,772.61	\$ 14,662,772.61
Allocation to other business based upon script volume	99.17% (14,541,071.60)	99.13% (14,535,206.49)
FEP portion of operating expenses	\$ 121,701.01	\$ 127,566.12
Admin fee charged to FEP business	\$ 111,947.98	\$ 111,947.98
Adjustment to FEP business	\$ 9,753.03	\$ 15,618.14

Rebates Shared		
	Original	Adjusted 02/03
Retail Rebates Earned	\$ (53,289,765.00)	\$ (53,289,765.00)
Allocate to other business based upon script volume	99.17% \$ 52,847,459.95	99.13% \$ 52,826,144.04
FEP portion of rebates earned	\$ (442,305.05)	\$ (463,620.96)
Rebates shared in 2000	\$ 362,327.79	\$ 362,327.79
Adjustment to FEP Programs	\$ (79,977.26)	\$ (101,293.17)

Net Adjustment to FEP		
	Original	Adjusted 02/03
Admin Fee Adjustment	\$ 9,753.03	\$ 15,618.14
Rebates Shared Adjustment	\$ (79,977.26)	\$ (101,293.17)
Adjustment Due to FEP Programs	\$ (70,224.23)	\$ (85,675.03)

Anthem Prescription Management, Inc.
2001 FEP True-up
Summary

Operating Expenses (Admin Fee)	
	Original
APM Operating Expenses	\$ 251,245,063.35
Less unallowed accounts	\$ (322,632.09)
Less unallowed cost centers	\$ (233,911,610.97)
Less allocations to Mail Services (non-FEP)	\$ (490,016.53)
Base allowable to FEP	\$ 16,520,803.76
Allocation to other business based upon script volume	98.96% (16,340,987.40)
FEP portion of operating expenses	\$ 171,816.36
Admin fee charged to FEP business	\$ 181,506.06
Adjustment to FEP business	\$ (9,689.70)

Rebates Shared	
	Original
Retail Rebates Earned	\$ 77,126,606.00
Allocate to other business based upon script volume	98.96% \$ (76,486,455.17)
FEP portion of rebates earned	\$ 640,150.83
Rebates shared in 2001	\$ 680,095.08
Adjustment to FEP Programs	\$ 39,944.25

Net Adjustment to FEP	
	Original
Admin Fee Adjustment	\$ (9,689.70)
Rebates Shared Adjustment	\$ 39,944.25
Adjustment Due to FEP Programs	\$ 30,254.55

	Adjusted 02/03
\$ 251,245,063.35	\$ 251,245,063.35
\$ (322,632.09)	\$ (322,632.09)
\$ (233,911,610.97)	\$ (233,911,610.97)
\$ (490,016.53)	\$ (490,016.53)
\$ 16,520,803.76	\$ 16,520,803.76
98.91% (16,340,727.00)	
\$ 180,076.76	\$ 180,076.76
\$ 181,506.06	\$ 181,506.06
\$ (1,429.30)	\$ (1,429.30)

	Adjusted 02/03
\$ 77,126,606.00	\$ 77,126,606.00
98.91% (76,285,925.99)	
\$ 840,680.01	\$ 840,680.01
\$ 680,095.08	\$ 680,095.08
\$ (160,584.93)	\$ (160,584.93)

	Adjusted 02/03
\$ (1,429.30)	\$ (1,429.30)
\$ (160,584.93)	\$ (160,584.93)
\$ (162,014.23)	\$ (162,014.23)

This information is confidential and for internal purposes only. It should not be disclosed to anyone outside the company or to a person within the company other than on a need to know basis.

2001 FEP True Up - Revised 02_03.xls (Exec. Summ ry)

2/9/2003